

Methods for managing and reducing personal debt

The Main Types of Personal Debt

1. “Good” Debt (Strategic and Long-Term)

Good debt typically helps you **build wealth or increase earning power** over time, but even good debt can become bad if borrowed excessively or without a clear plan for repayment.

Common examples:

- Student loans - when tied to a degree with strong earning potential
- Mortgages - for a reasonably priced home
- Business or professional education loans

2. “Bad” Debt (High Cost, Low Value)

Bad debt usually funds **depreciating purchases** or lifestyle spending and comes with high interest. This type of debt doesn’t improve your financial future—it often delays it.

Common examples:

- Credit card balances
- High-interest personal loans
- [Buy-now-pay-later \(BNPL\) plans](#) used frequently
- Payday or title loans

3. “Gray Area” Debt

Some debt depends on *how* and *why* you use it. A car loan for reliable transportation to work can be reasonable. A luxury car loan that strains your budget? Not so much.

Examples are auto loans and credit cards (when paid in full monthly).

Effective Methods for Managing and Reducing Debt

1. Choose a Repayment Strategy

Debt Avalanche

- Pay off highest interest rate first
- Saves the most money over time
- Best for math-focused savers

Debt Snowball

- Pay off smallest balance first
- Builds momentum and motivation
- Best if consistency is your challenge

Both work—the “best” one is the one you’ll stick with.

2. Automate Payments

- Set up **automatic minimum payments** to avoid late fees
- Add extra payments when possible
- Automation protects your credit and reduces mental load

3. Use Credit Cards Intentionally

- Treat credit cards as **payment tools**, not extra income
- Pay balances in full whenever possible
- Keep utilization low (ideally under 30% of your limit)

Used correctly, credit cards can build strong credit without costing you interest.

4. Avoid Lifestyle Inflation

As your income grows, it’s tempting to upgrade everything at once. Instead:

- Increase savings and debt payments first
- Delay “luxury” upgrades
- Let your financial foundation catch up to your paycheck

5. Know When to Get Help

Debt doesn’t mean failure—it means you need a plan.

Consider:

- Nonprofit credit counseling
- Employer financial wellness programs
- Reputable budgeting or debt-tracking apps

Avoid quick fixes or companies promising “instant debt relief.”

How to keep your personal debt under control

The Golden Rule: Live Below Your Means

The simplest way to avoid debt is to **spend less than you earn**. It sounds obvious, but in a world of "Buy Now, Pay Later" and Instagram-worthy lifestyles, it's easy to let your spending creep up.

1. The 50/30/20 Rule

This is the easiest [framework](#) for a young adult to follow.

Break your monthly take-home pay into three buckets:

- **50% for Needs:** Rent, groceries, utilities, and transport.
- **30% for Wants:** Dining out, hobbies, and subscriptions.
- **20% for Financial Goals:** This is your "debt shield." Use it to build an emergency fund first, then for investments.

2. Build a "Starter" Emergency Fund

Most debt happens when an unexpected expense—like a flat tire or a broken phone—hits. Before you worry about complex investments, [save \\$1,000 to \\$2,000](#) as fast as possible. This ensures that when life happens, you reach for your savings instead of a credit card.



Key Financial Calculations to Monitor Your Health

To stay in control, you need to know your numbers. Use these two simple formulas once a month to make sure you aren't drifting into the "danger zone."

(1) Debt-to-Income (DTI) Ratio

Lenders use this to see if you're "over-leveraged." As a young adult, [keeping this low](#) ensures you can qualify for a car loan or mortgage later.

Formula: $Total\ Monthly\ Debt\ Payments / Gross\ Monthly\ Income$

- **Gross Monthly Income:** Your pay before taxes.
- **Healthy Range:** Aim for **under 30%**. If your DTI hits 43%, most lenders will consider you a high-risk borrower.

(2) The Credit Utilization Ratio

If you use a credit card to build credit, this is the most important number for your credit score. It [measures](#) how much of your available limit you are actually using.

Formula: $(Total\ Outstanding\ Balances / Total\ Credit\ Limits) \times 100$

- **The Goal:** Keep this **below 30%**. For example, if your card has a \$1,000 limit, never let the balance sit above \$300. Ideally, pay it off in full every month to keep it at 0%.